

Fraternal Society Exemption



OFFICE OF THE STATE AUDITOR

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Colorado levies a 2 percent insurance premium tax on the amount of premiums that insurers collect from policyholders in the state. Fraternal societies are organizations of people with a common tie or objective that provide benefits, such as life insurance, to their members and engage in charitable and/or community initiatives. The Fraternal Society Exemption allows these societies to issue insurance policies to their members without paying insurance premium taxes on the premiums paid by members. The exemption was likely intended to avoid imposing a tax burden on fraternal societies due to the societal benefits they provide.

The Fraternal Society Exemption is applied to all premiums collected by fraternal societies on policies issued to members.

- All 36 fraternal societies that were licensed in Colorado in 2022 received the exemption on premiums reported to the Division of Insurance.
- Representatives of the fraternal society sector reported that the sector is very aware of the exemption and that the exemption allows them to expand their charitable and fraternal activities in their communities.

Policy Considerations

We did not identify any new policy considerations for the exemption.

Tax Type:	Insurance premium tax	Year Enacted:	1883
Expenditure Type:	Exemption	Repeal/Expiration date:	None
Statutory Citation:	Sections 10-3-209(1)(d)(I) and 10-14-504, C.R.S.	Revenue Impact (2022):	\$3.3 million

Purpose given in statute or enacting legislation? **No**



Fraternal Society Exemption

Background

Colorado levies a 2 percent insurance premium tax on the amount of premiums that insurers collect from policyholders in the state. **The Fraternal Society Exemption allows fraternal benefit societies to issue insurance policies to their members without paying insurance premium taxes on the premiums paid by members.**

Fraternal benefit societies (fraternal societies) are organizations of people in which membership is based on a common tie or objective. They provide benefits to their members and may also engage in charitable, educational, or community initiatives. Fraternal societies were most popular in the late 19th and early 20th centuries, when they issued roughly half of all life insurance policies in the United States. The total number of fraternal societies operating in the United States has declined slowly since the 1920s. The American Fraternal Alliance (AFA) estimates that there were about 109,000 Coloradans who belonged to fraternal societies in 2022, and about 91,000 (83 percent) of these members held a life insurance policy or certificate issued by their fraternal society.

The exemption was likely intended to avoid imposing a tax burden on fraternal societies due to the societal benefits they provide. Since the exemption was enacted at the same time as the insurance premium tax in 1883, it appears that the exemption was not intended to provide a new benefit for fraternal societies but rather to define which types of insurers would be subject to the newly imposed premium tax. Additionally, statute states that fraternal societies are “charitable and benevolent institution[s]” and exempts them from most state and local taxes [Section 10-14-504, C.R.S.]. Representatives of the fraternal society sector reported that the exemption is helpful for their operations because it allows them to expand their charitable and fraternal activities in their communities. The AFA reports that Colorado fraternal members spent over 750,000 hours volunteering and provided more than \$9 million in financial contributions to communities in 2021. All other states and the District of Columbia exempt fraternal societies from their respective insurance premium taxes.

Technical Note:

In order to qualify for the exemption, statutes require a fraternal society to:

- Be governed by a board or assembly of delegates that are elected by the society’s members.
- Conduct its business via local chapters that meet at least once per month.
- Provide social, intellectual, educational, charitable, benevolent, moral, fraternal, patriotic, or religious benefits to its members.
- Provide members and their dependents with contractual benefits, which may include annuities or death, disability, or medical benefits, among others.
- Not issue stock or be conducted for profit.

In order to determine whether the exemption is meeting its purpose, we assessed the extent to which the exemption is applied to premiums paid for insurance policies issued by fraternal societies.

Evaluation Results

The Fraternal Society Exemption is applied to all premiums that fraternal societies collect from Colorado policyholders.

In 2022, there were 36 licensed fraternal societies in Colorado. Based on information from the Division of Insurance (Division), fraternal societies that are licensed with the State are receiving the exemption for all premiums collected from their members on Colorado policies. Like other types of insurers, fraternal societies are required to file annual statements with the National Association of Insurance Commissioners (NAIC) and complete the same annual insurance premium tax filing process with the Division in Colorado. Division staff reported that their tax system recognizes filings from fraternal societies based on each society's NAIC number and automatically exempts the society's reported premiums from the insurance premium tax. Therefore, any premiums reported by insurers that are registered as fraternal societies with the NAIC and are licensed with the Division are exempt from Colorado's insurance premium tax. Finally, fraternal society sector representatives reported that the sector is very aware of the exemption, and no new fraternal societies have been created in several decades, so most likely, every fraternal society is correctly registered with the NAIC and is receiving Colorado's exemption.

Based on NAIC data, fraternal societies collected about \$166 million in exempt premiums in Tax Year 2022, so the exemption reduced the State's insurance premium tax revenue by about \$3.3 million. Notably, Colorado statute also exempts premiums paid for certain types of annuities from the insurance premium tax, and premiums paid for annuities accounted for about \$71 million (43 percent) of the premiums paid to fraternal societies; however, we were unable to determine what percentage of these premiums would have also qualified for the exemption for annuities.

Policy Consideration

We did not identify any new policy considerations for the exemption. In our previous evaluation of the exemption, released in January 2019, we included a policy consideration that the General Assembly may want to assess whether the exemption continues to serve a valid purpose because of its age and the large changes in both the role of fraternal societies and the insurance industry since the exemption was created. Two interim legislative committees (the Tax Expenditure Evaluation Interim Study Committee in 2019 and the Legislative Oversight Committee Concerning Tax Policy in 2022) reviewed this policy consideration and elected not to take any legislative action.

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